DEPARTMENT OF STATE REVENUE

04960089.LOF

LETTER OF FINDINGS NUMBER: 96-0089
Sales and Use Tax
For the Period: 1992 through 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales/Use Tax - Manufacturing Exemption on Spools

Authority: IC 6-2.5-5-5.1; 45 IAC 2.2-5-10.

The taxpayer protests the use tax assessed on wooden and plastic spools.

II. Sales/Use Tax - Computers

Authority: IC 6-2.5-3-2; IC 6-2.5-3-1; US Air, Inc. v. Indiana Department of State Revenue, 623 N.E.2d 466 (Ind. Tax 1993); Minnesota Regulation 8130.1300; Dahlberg Hearing Systems, Inc. v. Commissioner of Revenue, C2-95-1929, April 25, 1996.

The taxpayer protests the use tax assessed on computers loaded with software and tested in Indiana.

III. Tax Administration - Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2.

The Taxpayer protests all assessed penalties.

STATEMENT OF FACTS

The taxpayer manufactures and sells magnetic wire to customers that use the wire in their production processes. The taxpayer sells the wire on plastic and wooden spools. The spools make it possible to transport and use the wire without it tangling. The taxpayer charges a deposit on the wooden spools which is repaid when the spools are returned, but no deposit is charged on the plastic spools. Many of the spools are shipped outside Indiana.

The taxpayer purchases computers in Indiana, loads them with software, and tests them at its Indiana location, and then ships the computers outside Indiana.

More information will be provided as necessary.

I. Sales/Use Tax - Manufacturing Exemption on Spools

DISCUSSION

The taxpayer ships its wire on one of two types of spools. Wooden spools, upon which a deposit is required, and plastic spools, upon which no deposit is required. Although no deposit is required on the plastic spools, many customers return them to the taxpayer because it is easier and more cost effective than disposal. The taxpayer reuses the plastic spools more than once if they retain their integrity.

The taxpayer asserts that the spools are integrated into the wire as packaging and that the cost of the spools are included in the price of the wire and therefore, sales tax is collected on the spools when it is collected on the wire. The taxpayer claims that without the spools, the wire would be tangled and impossible to use.

Indiana Code 6-2.5-5-5.1(b) states in pertinent part:

> Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the business of manufacturing, processing . . .

Furthermore, Administrative Regulation 45 IAC 2.2-5-10(d) states in pertinent part:

> 'Direct use' begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the processing or refining has altered the item to its completed form, including packaging, if required.

The wooden spools are returnable. Since a deposit is received on the spools to ensure their safe return, they are not sold as a part of the selling price of the wire. Therefore, use tax must be paid for their use in Indiana.

The plastic spools, while sometimes returned, are not made to be reused more than a couple of times and the taxpayer makes no special effort to ensure that these spools are returned. These spools are sold as part of the selling price of the wire. Therefore, sales tax on the spools is collected when it is collected on the wire.

FINDING

The taxpayer's protest is denied in part and sustained in part. The taxpayer's protest of the wooden spools is denied. The taxpayer's protests as to the plastic spools is sustained.

II. Sales/Use Tax - Computers

DISCUSSION

The taxpayer purchased computers in Indiana, loaded the computers with software, tested the software, and shipped the computers out of Indiana. The taxpayer asserts that the computers are exempt from use tax because they are stored in Indiana solely for use outside Indiana. The taxpayer asserts that the computers are "temporarily stored" in Indiana, and offers the Minnesota Supreme Court ruling in Dahlberg Hearing Systems, Inc. v. Commissioner of Revenue, C2-95-1929, April 25, 1996. The Minnesota Supreme Court found that the taxpayer was not required to pay use tax on computers that were brought into Minnesota for the purpose of installing software, testing the equipment, and subsequently shipping the equipment to other states for usage. The Court found that the equipment was temporarily stored in Minnesota and therefore not subject to Minnesota use tax even though the seller was required to collect Minnesota sales tax when the taxpayer purchased the equipment in Minnesota.

In the case at hand, the taxpayer purchased the computers in Indiana, loaded them with software, tested the software, and shipped them outside Indiana for use in other states.

The Department looks at other state's case law as persuasive only. Minnesota's definition of the term "use" is different than that of Indiana's. Minnesota Regulation 8130.1300 provides in pertinent part:

> 'Use' does not include storing personal property to be used in the ordinary course of an owner's trade or business where such personal property is subsequently shipped or delivered to an ultimate destination outside Minnesota without being put to an intermediate use in this state and thereafter not returned to Minnesota except in the course of interstate commerce.(As used herein, the term 'intermediate use' does not include processing, fabricating, or manufacturing into or incorporating into other tangible personal property or testing to modifying tangible personal property but includes consuming or enjoying the beneficial use of the property.)

Indiana statutes do not except use tax for use that is less than intermediate and does not specifically except testing or modifying tangible personal property. Indiana may not follow Minnesota law, but must follow the intent of its own statutes and case law.

Indiana Code 6-2.5-3-2 states:

> (a) An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction, regardless of the location of that transaction or the retail merchant making that transaction.
>
> (d) Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining or exercising of any right or power over tangible personal property, if:
>
> (1) the property is delivered into Indiana by or for the purchaser of the property;
>
> (2) the property is delivered in Indiana for the sole purpose of being processed,
>
> printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property; and
>
> (3) the property is subsequently transported out of state for use solely outside Indiana.

In this case, element (1) is not met because the property was not shipped to the taxpayer from outside Indiana.

"Use" is defined as the exercise of any right or power of ownership over tangible personal property, and "Storage" is defined as keeping or retaining tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana. IC 6-2.5-3-1(a)&(b).

Storage was the main issue in dispute in US Air, Inc. v. Indiana Department of State Revenue, 623 N.E.2d 466 (Ind. Tax 1993)(hereinafter US Air). Use and storage in Indiana is taxable, but if storage is solely for subsequent use outside Indiana, then the use is exempt. US Air at 470. In US Air, the airline sought a refund of use tax paid on food purchased for consumption on its flights. The court found that the airline had not "stored" the food in Indiana for use outside Indiana when it received the food, determined which planes would carry which food, and determined whether the food would be placed in the cabin or the belly, and then transported the food outside Indiana. Id.

The use of food in U.S. Air is comparable to the taxpayer's use of computers in Indiana. In both cases, the use constituted more than mere storage in Indiana solely for use outside Indiana and is therefore subject to use tax.

FINDING

The taxpayer's protest is denied.

III. Tax Administration - Penalty

DISCUSSION

The taxpayer protests the Department's imposition of the ten percent (10%) penalty. The taxpayer offers the following reasons why the penalty should be waived:

(a) The taxpayer had a good faith belief that it was following Indiana law,

(b) The taxpayer relied on past Letter of Findings in its decision not to pay use tax,

(c) The taxpayer has systems in place to catch tax errors and are continually revising that system to be more efficient, and

(d) The assessments were not the result of willful intent by the company or its employees.

Indiana Code 6-8.1-10-2.1 subjects a person to a ten percent (10%) penalty, if the person incurs a deficiency that is due to negligence. However, IC 6-8.1-10-2.1(d) states, "If a person subject to the penalty imposed under this section can show that the failure . . . was due to reasonable cause and not due to willful neglect, the department shall waive the penalty."

Administrative Rule 45 IAC 15-11-2(c) states in part, "The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 (repealed, now 6-8.1-10-2.1) if the taxpayer affirmatively establishes that the failure to . . . pay the full amount due. . . was due to reasonable cause and not due to negligence."

Administrative Rule 45 IAC 15-11-2(b) provides guidance in determining whether a taxpayer is negligent, and states:

> 'Negligence' on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence.

In this case, the taxpayer had a reasonable belief that it was complying with the use tax statutes. The taxpayer has proven that avoidance of the tax was not intentional and was due to reasonable interpretation.

FINDING

The taxpayer's protest of penalty is sustained.